

Message Text

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AMEMBASSY KIGALI
AMEMBASSY KINSHASA
AMEMBASSY LUSAKA
AMEMBASSY LONDON
AMEMBASSY VICTORIA

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TAGS: BGEN, ECON, EFIN, ETRD, KE

SUBJ: KENYAN ECONOMIC PERFORMANCE IN 1976

REF (A) 76 NAIROBI A-47, (B) 76 NAIROBI A-92

1. SUMMARY. SOMEWHAT SURPRISING TO IMF AND MANY LOCAL OBSERVERS
WAS POSSIBILITY EMERGING IN LATE 1976 OF BALANCE OF PAYMENTS
SURPLUS (\$67 MILLION) FOR 1976. COFFEE REVENUES NARROWED
GAP ON 1976 MERCHANDISE ACCOUNT CONSIDERABLY AND PROMISED
TO FACILITATE BOP SURPLUS AGAIN IN 1977. GDP GROWTH NOW
ESTIMATED AT 4 TO 4.5 PERCENT FOR 1976 COMPARED TO LESS THAN
1 PERCENT IN PREVIOUS YEAR. AGRICULTURAL PRODUCTION OVER-
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CAME CRIPPLING WEATHER CONDITIONS IN EASTERN KENYA TO REGISTER
1 PERCENT INCREASE IN VALUE OVER 1975. INDUSTRIAL
SACTIVITY LIKEWISE INCREASED 8 PERCENT BUT CONSTRUCTION
SECTOR STILL IN SERIOUS DEPRESSION. FOREIGN EXCHANGE
RESERVES, AT \$273 MILLION (NOV. 1), COVERED THREE AND
ONE-HALF MONTHS IMPORTS AND REPRESENT THE HEALTHIEST LEVEL
SINCE 1971. IRONICALLY, KENYA MADE TWO DRAWINGS FROM

IMF POOLS ESTABLISHED TO HELP MEMBERS WITH BALANCE OF PAYMENTS DIFFICULTIES BEFORE SIZE OF COFFEE BONANZA FULLY REALIZED. COST OF LIVING ROSE 10-14 PERCENT, REDUCED FROM 20 PERCENT JUMP IN 1975. BUOYANT TRADE PERFORMANCE AND IMPROVING AGRICULTURAL REVENUES DEPENDENT ON TEMPORARY COFFEE BOOM, WHILE BUSINESS AND PERSONAL INVESTMENT PLANNING REMAIN CAUTIOUS.

2. KENYA ENTERS 1977 WITH SUBSTANTIAL FOREIGN RESERVES AND HIGH BANK LIQUIDITY -- AMPLE FUEL TO STIMULATE DOMESTIC INVESTMENT LAGGING OVER PAST THREE YEARS. FIVE-YEAR DEVELOPMENT PLAN IS DUE FOR RENEWAL IN MID-1978 WITH EXPECTED EMPHASIS ON BOOSTING AGRICULTURAL PRODUCTION AND ENCOURAGING EXPORT-COMPETITIVE INDUSTRY. GOVERNMENT BORROWING FROM COMMERCIAL BANKING SYSTEM OVERRAN CENTRAL BANK CREDIT GUIDELINES IN 1976 AND LIKELY TO BECOME PROBLEM IN 1977 AS DEFENSE BUDGET BEINGS STEEPER RISE. UNCERTAIN FUTURE OF EAST AFRICAN COMMUNITY MAY PROVE DISRUPTIVE TO TRANSPORTATION NETWORK AND INTER-STATE TRADE, WHILE POSSIBLE SPIN-OFF OF SOME SERVICES, LIKE EAST AFRICAN AIRWAYS, TO INDIVIDUAL STATES COULD INCREASE KENYA'S DEBT COMMITMENTS AND INFRASTRUCTURE REQUIREMENTS. HIGHER OIL PRICES, DEPENDING ON FINAL BLENDED PERCENTAGE HIKE, WOULD ADD \$12-20 MILLION TO COUNTRY'S IMPORT BILL. END SUMMARY.

3. BALANCE OF PAYMENTS: THANKS PRIMARILY TO BOOMING COFFEE REVENUES, KENYA EXPECTS BALANCE OF PAYMENTS SURPLUS IN 1976 AND, TO SMALLER EXTENT, AGIN IN 1977. RECENT UNCLASSIFIED

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CENTRAL BANK ESTIMATES PREDICT \$67.46 MILLION SURPLUS FOR PAST YEAR, WHILE TREASURY FORECASTS MORE OPTIMISTIC \$76.55 MILLION. BASED ON ACTUAL STATISTICS FOR FIRST EIGHT MONTHS OF YEAR, CENTRAL BANK CONCLUDED THAT 1976 TRADE GAP WOULD APPROACH \$260 MILLION, WHICH WOULD BE NARROWED CONSIDERABLY BY \$185.5 MILLION IN REVENUE FROM INVISIBLES. CAPITAL INFLOWS MAY CONTRIBUTE ANOTHER \$111 MILLION, WHILE IMF DRAWINGS TOTALLED \$32 MILLION. FINANCE MINISTER KIBAKI SURPRISED MANY OBSERVERS WHEN HE ANNOUNCED AT NOVEMBER CONSULTATIVE GROUP MEETINGS WITH IBRD IN PARIS THAT GOK EXPECTED TO END 1976 WITH SURPLUS IN ITS ACCOUNTS. AS EXTENT OF COFFEE REVENUES BECAME KNOWN, MAGNITUDE ASTOUNDED MANY GOVERNMENT ECONOMISTS AND CONTRADICTED OFFICIAL KENYAN AS WELL AS IMF PROJECTIONS IN WHAT ONE CENTRAL BANK OFFICIAL DESCRIBED AS A TERRIBLE YEAR FOR FORECASTING.

4. TRADE: IN JANUARY 1977 ESTIMATE PREPARED FOR IMF CONSULTATION CENTRALBANK CALCULATED KENYA'S 1976 TRADE

BILL WOULD TOTAL \$1.01 BILLION FOR IMPORTS VERSUS EXPORT REVENUE OF \$750 MILLION. ACTUAL FIGURES THROUGH JULY 1976 SHOWED TRADE EARNINGS RUNNING 56 PERCENT ABOVE FIRST HALF OF 1975 AND IMPORT COSTS UP 12 PERCENT. AT THAT RATE, MERCHANDISE ACCOUNT WOULD REACH CLOSE TO \$935 MILLION FOR IMPORTS AND \$775 MILLION FOR EXPORTS. IN EITHER CASE, TRADE GAP REMAINING TO BE BRIDGED BY INVISIBLES AND CAPITAL INFLOWS IS MUCH LESS THAN IN RECENT YEARS WHEN EXPORT SALES FAILED TO KEEP PACE WITH GROWING COSTS OF OIL SHIPMENTS AND MANUFACTURED GOODS.

5. IMPORTS OF CRUDE PETROLEUM COST \$148.8 MILLION IN FIRST SEVEN MONTHS OF 1976, ALMOST 30 PERCENT ABOVE SAME PERIOD IN 1975. EXPORTS OF REFINED PRODUCTS SHOWED 14 PERCENT DECLINE IN SAME PERIOD, REFLECTING, IN PART, TEMPORARY INTERRUPTION OF SUPPLIES TO RWANDA, BURUNDI, ZAIRE, AND SUDAN DUE TO KENYAN-UGANDAN POLITICAL DISPUTES. OVERLAND UNCLASSIFIED

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SHIPMENTS WERE RESUMED BY SEPTEMBER, SO KENYA PROBABLY EARNED AROUND \$80 MILLIN FOR WHOLE YEAR.

6. MONETARY POLICY: MAIN ELEMENTS OF GOK MONETARY POLICY INCLUDE LIMITS ON GOVERNMENT BORROWING FROM BANKING SYSTEM, MODEST EXPANSION OF DOMESTIC CREDIT AND DIRECTION OF AVAILABLE FUNDS TO PRIORITY PRIVATE SECTORS, AND CONSERVATIVE LIMITS ON GROWTH OF MONEY SUPPLY TO DILUTE INFLATIONARY IMPACT OF GROWING FOREIGN EXCHANGE RESERVES AND BANK LIQUIDITY.

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7. BANKING SYSTEM MET CREDIT AND MONEY SUPPLY TARGETS WITH MIXED SUCCESS. TOTAL DOMESTIC CREDIT INCREASED 18 PERCENT DURING FY76 AND WENT UP ADDITIONAL 11 PERCENT THROUGH NOVEMBER 1976. CENTRAL BANK GUIDELINES CALLED FOR 16 PERCENT AVERAGE ANNUAL INCREASE. 13-15 PERCENT THROUGH JUNE 1976, FAILED TO REACH TARGET OF 17 PERCENT OF NET DEPOSIT LIABILITIES. MONEY SUPPLY DEFINED AS CURRENCY IN CIRCULATIONS PLUS PRIVATE BANK DEPOSITS) ROSE SHARP 23 PERCENT IN FY 76 AND HAS CLIMBED ADDITIONAL 9 PERCENT FROM JUNE TO NOVEMBER 1976. THIS INCREASE APPEARS TO HAVE BEEN SUPPORTED LARGELY BY GOVERNMENT BORROWING AND STEADY GROWTH IN FOREIGN EXCHANGE
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RESERVES.

8. CENTRAL GOVERNMENT BORROWING CONSISTENTLY ELUDED CENTRAL BANK CONTROL THROUGH 1976 AND REMAINS SERIOUS PROBLEM FOR GOK MONETARY AUTHORITIES IN F
LU ACCORDING
TO CENTRAL BANK FIGURES, GOK HAS ALREADY CONSUMED OVER 90 PERCENT OF ITS TARGET CREDIT FOR FY 77. BANK EXPECTS TO RECEIVE URGENT APPEAL FOR ADDITIONAL ACCESS WITHIN NEXT COUPLE OF MONTHS, AS HAPPENED YEAR AGO WHEN FY 76 BUDGET OVERRUN WAS DISCOVERED. PERHAPS ONLY REASON SUCH EXCESS FINANCING HAS NOT HAD MAJOR INFLATIONARY CONSEQUENCES SO FAR IS ITS COINCIDENCE WITH PERIOD OF HIGH BANK LIQUIDITY AND DEFICIENT AGGREGATE DEMAND. NEVERTHELESS, CENTRAL BANK IS UNWILLING FOR SEVERAL REASONS TO MINIMIZE IMPORTANCE OF RESTRICTING GOVERNMENT CREDIT: PROBLEM IS INDICATIVE OF LACK OF ADEQUATE MINISTERIAL FISCAL CONTROLS; EXPECTED 1977 ECONOMIC UPTURN IN PRIVATE SECTOR DESERVES LARGER SHARE OF AVAILABLE CREDIT; AND OUTSTANDING COMMITMENTS TO IMF UNDER 1975 EXTENDED FUND FACILITY

DRAWING HAVE NOT BEEN MET.

9. IMPORTANT FACT WHICH BEARS REPETITION IS THAT LARGE FOREIGN EXCHANGE INFLOWS PLUS SLACK DEMAND FOR COMMERCIAL CREDIT ALMOST EMBARRASSINGLY IMPROVED BANK LIQUIDITY. AVERAGE LIQUIDITY RATION (LIQUID ASSETS TO NET DEPOSIT LIABILITIES) ROSE STEADILY THROUGH YEAR TO NEARLY 29 PERCENT (COMPARED TO LEGAL MINIMUM OF 18 PERCENT). CENTRAL BANK ECONOMISTS ADMIT THAT ATTEMPTING TO PUMP THESE FUNDS INTO PRODUCTIVE (I.E. AGRICULTURAL AND MANUFACTURING) SECTORS IS LIKE "PUSHING ON A STRING." CREDIT DEMAND IS UNUSUALLY LOW. EVEN COFFEE REVENUES APPEAR TO BE ACCUMULATING IN TIME DEPOSITS RATHER THAN FEEDING INTO INVESTMENT OR CONSUMPTION. FLOOR ON SHORT-TERM LENDING RATES WAS LOWERED IN DECEMBER AMIDST CENTRAL BANK PUBLICITY THAT THIS WOULD ENCOURAGE POTENTIAL BOR-

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ROWERS. COMMERCIAL BANKS, ON THE OTHER HAND WOULD HAVE PREFERRED MORE FLEXIBLE CEILINGS. THEIR CONTENTION IS THAT MORE BORROWERS COULD BE SATISFIED IF INTEREST RATES WOULD RISE HIGH ENOUGH TO COVER HIGHER RISKS FORESEEN IN EXTENDING CREDIT TO SMALL LANDHOLDERS OR INDUSTRIALISTS.

10. AGRICULTURAL PRODUCTION: DESPITE BELOW NORMAL RAINFALL IN GOOD PART OF EASTERN KENYA, PRELIMINARY GOK ESTIMATES INDICATE AN 8 PERCENT REAL INCREASE IN VALUE OF MARKETED AGRICULTURAL PRODUCTION DURING 1976. MOST OF ESTIMATED \$504 MILLION EARNINGS WAS CONTRIBUTED BY HIGHER COFFEE PRICES, WHICH ACCOUNTED FOR ABOUT \$185 MILLION. COFFEE DELIVERIES FOR FIRST THREE-QUARTERS RAN 28 PERCENT ABOVE 1975 AS FAVORABLE PRICES INDUCED EARLY MARKETING. WHEAT AND MAIZE DELIVERIES TO MARKETING BOARDS WERE RESPECTIVELY 23 PERCENT AND 19 PERCENT HIGHER THAN PREVIOUS YEAR. TEA OUTPUT LIKEWISE ROSE 14 PERCENT. ON OTHER HAND, DELIVERIES OF PYRETHRUM FLOWERS DROPPED 12 PERCENT FROM 1975'S RECORD AND EXTRACT PRODUCTION DECREASED BY 14 PERCENT. SISAL PRODUCTION -- DRASTICALLY REDUCED SINCE OVER-HARVESTING IN 1974 -- FELL FOR SECOND YEAR. LIVESTOCK PRODUCTION, SENSITIVE TO BOTH DROUGHT CONDITIONS AND GOK PRICING POLICIES, WAS ERRATIC IN VOLUME AND QUALITY. LATE 1976 INCREASES IN DOMESTIC PRICES FOR WHEAT, MAIZE, PYRETHRUM, MILK, AND BEEF MAY HELP STIMULATE 1977 MARKETS AS LONG AS WEATHER CONDITIONS ARE FAVORABLE. KENYA ALSO COUNTING ON ANOTHER RECORD YEAR FOR COFFEE PRICES.

11. MANUFACTURING: GOK PRODUCTION INDEX FOR MANUFACTURING SECTOR DISPLAYED 8 PERCENT INCREASE OVER 1975, THANKS

PARTICULARLY TO OUTPUTS OF METAL, RUBBER, AND PAPER INDUSTRIES. FOOD PRODUCTION VARIED GREATLY, DEPENDING ON COMMODITY: RISES IN FLOUR AND BREAD OFFSETTING DECLINES IN SUGAR AND MEAT PRODUCTS. OIL REFINERY THROUGHPUT
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FELL 8 PERCENT IN FIRST SIX MONTHS, ALTHOUGH DOMESTIC CONSUMPTION OF PETROLEUM PRODUCTS ROSE 5 PERCENT AND CRUDE IMPORTS WERE SLIGHTLY HIGHER. ACCORDING TO AN INDUSTRY SOURCE, THIS DECLINE IN PRODUCTION IS PRIMARILY DUE TO A DROP IN UGANDAN PURCHASES. EXPORTS SHOWED LITTLE GROWTH OVER 1975, A CONSEQUENCE OF TEMPORARY INTERRUPTION OF SUPPLIES TO KENYA'S TRADITIONAL MARKETS IN NEARBY COUNTRIES (SEE PARA 5). ACCORDING TO GOK STATISTICS, MANUFACTURERS' STOCKS OF FINISHED PRODUCTS AND RAW MATERIALS WERE NOT SIGNIFICANTLY DEPLETED FROM GENERALLY HIGH LEVELS OF 1974 AND 1975.

BUILDING AND CONSTRUCTION: ALTHOUGH INFLATION IN BUILDING COSTS MODERATED SUBSTANTIALLY OVER 1976, CONSTRUCTION ACTIVITY -- IN TERMS OF NEW UNITS COMPLETED -- FELL 60 PERCENT. NOR DOES INDUSTRY SHOW ANY SIGNS OF EARLY RECOVERY, JUDGING FROM LOW NUMBER OF BUILDING PERMITS APPROVED IN RECENT MONTHS. BUSINESS CIRCLES ATTRIBUTE CONSTRUCTION FALL-OFF TO IMPOSITION OF CAPITAL GAINS TAX IN MID-1976, WHICH RESULTED IN 35 PERCENT CHARGE ON PROPERTY TURNOVERS. MORE LIKELY EXPLANATION SEEMS TO BE THAT CONSTRUCTION INDUSTRY SENSITIVELY REFLECTS KENYA'S ECONOMIC DOLDRUMS, WHICH APART FROM COFFEE BONANZA IS CHARACTERIZED BY STAGNANT GROWTH IN REAL INCOMES, AND RELATIVELY HIGH RATE OF BUSINESS FAILURES. PUBLIC WORKS EXPENDITURES HAVE ALSO ASSUMED LOWER PRIORITY IN GOK DEVELOPMENT PLANNING.

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12. EMPLOYMENT/COST OF LIVING: DIRECTLY INFLUENCED BY
PREVAILING PRODUCTION LEVELS, EMPLOYMENT IN MODERN SECTOR
ROSE 5 PERCENT IN 1976-- 3 PERCENT IN MANUFACTURING ALONE.
INCREASE IN COST OF LIVING MODERATED SIGNIFICANTLY IN 1976
AFTER 20 PERCENT JUMP DURING PREVIOUS YEAR. CONSUMER PRICES
ROSE BETWEEN 10 AND 14 PERCENT, A SURPRISINGLY MILD REACTION
TO LATE-1975 CURRENCY DEVALUATION. IN ITS 1976 REPORT,
CENTRAL BANK ATTRIBUTED THIS SUCCESS TO REDUCTION IN
INFLATION IMPORTED ITEMS. HOWEVER, SELECTED COMMODITIES
HEAVILY DEPENDENT ON IMPORTED INTERMEDIATE GOODS REGISTERED
HIGHEST PRICE INCREASES: UTILITIES AND TRANSPORT 23 PERCENT
EACH, FURNITURE 29 PERCENT. DOMESTICALLY PRODUCED PRODUCED
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CONSUMER ITEMS SUCH AS FOOD, BEVERAGE AND CLOTHING ROSE
ONLY ABOUT 10 PERCENT.

13. IN CONCERTED EFFORT TO BOOST AGRICULTURAL PRODUCTION,
GOK HAS INCREASED PRODUCER PRICES IN STAGES OVER 1975-7.
RETAIL PRICES, THOUGH, HAVE NOT BEEN RAISED, CATCHING
INTERMEDIATE MARKETING BOARDS IN PROFIT SQUEEZE WHICH, FOR
SOME, HAS MEANT BANKRUPTCY. BOARDS HAVE SURVIVED ON BANK
OVERDRAFTS AND BY DEFERRING PAYMENTS TO PRODUCERS,
BUT GOK INTERCESSION IN FORM OF FINANCIAL
SUBSIDIZATION WILL BE REQUIRED IN 1977 UNLESS CONSUMER
PRICE CEILINGS ARE LIFTED.

14. COMMENT GOK APPEARS TO BE DOWN-PLAYING THIS 1976 ECONOMIC
ACHIEVEMENT FOR MOTIVES OTHER THAN RELUCTANCE TO COUNT ITS

YET UNTABULATED CHICKENS. EXPORT WINDFALL IS PURELY TEMPORARY PHENOMENON DEPENDENT ON VOLATILE COMMODITY MARKETS. SOME OF CURRENTLY HIGH FOREIGN EXCHANGE RESERVES ARE EARMARKED FOR PROJECTED DEFENSE EXPENDITURES OVER NEXT FEW YEARS. CAPITAL REQUIREMENT FOR LONG-TERM DEVELOPMENT PLANNING CLEARLY CONTINUE TO JUSTIFY PROJECT-ORIENTED EXTERNAL ASSISTANCE; YET THE COUNTRY'S LOW DEBT SERVICE RATIO COULD ABSORB MORE CREDIT ON COMMERCIAL TERMS. IMF IS ALSO LIKELY TO BE SOMEWHAT SKEPTICAL OF KENYA'S NEED FOR LIKE-LINE FUNDING RECENTLY ESTABLISHED FOR BENEFIT OF MSA'S. IMF DRAWINGS MADE DURING 1976 TOTALLED SDR 27.10 FROM THE COMPENSATORY FUND FACILITY AND 1975 OIL FACILITY. A REQUEST WAS SUBMITTED IN OCTOBER FOR A TRUST FUND DRAWING. THOUGH PROUD OF ITS PROVEN ABILITY TO MANAGE CAPITAL RESOURCES THROUGHOUT RECENT OIL CRISIS, GOK HAS NO DESIRE TO MINIMIZE COUNTRY'S ELIGIBILITY FOR SHORT-TERM BILATERAL AND MULTILATERAL AID BY FLAUNTING ITS 1976 ECONOMIC RECORDS. TO OUTSIDERS, HOWEVER, THERE IS NO OBSCURING FACT THAT RECORD WAS GOOD.

15. USAID WISHES POINT OUT RE PRECEDING PARA THAT AT CG MEETING GOK CALLED ATTENTION TO FACT KENYA STILL IN POOR UNCLASSIFIED

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CATEGORY ALTHOUGH NOT CLASSIFIED AS RLDC, THAT IBRD STATED KENYA STILL IDA-ELIGIBLE COUNTRY, AND THAT SCANDINAVIAN DELEGATE SAID MOST CONCESSIONAL ASSISTANCE PROVIDED NATIONS HAVING PER CAPITA INCOMES OF \$300 OR LESS (SEE PARIS 35189). KENYA PCI OF \$230 WELL UNDER THIS CEILING. WHILE 1976 ECONOMIC PERFORMANCE BETTER THAN ANYONE HAD ANTICIPATED, THIS LARGELY DUE (AS NOTED ABOVE) TO BOOM IN COFFEE PRICES AND GENERALLY FAVORABLE WEATHER CONDITIONS, BOTH OF WHICH FACTORS SUBJECT TO CHANGE. AS CLEAR FROM ABOVE PARAS, GOK STILL FACED WITH SIGNIFICANT ECONOMIC PROBLEMS, SUCH AS HIGH INFLATION, NEED FOR BETTER CONTROL OVER GOVERNMENT EXPENDITURES, AND NEED TO RAISE GDP GROWTH RATE TO 5.5-6.0 PERCENT, WHICH IBRD STATES IS MINIMUM SOCIALLY ACCEPTABLE LEVEL AND WHICH GOK INTERIM ACTION PLAN TARGET UNTIL ABLE TO REACH HIGH GROWTH RATES IN 1980'S. MARSHALL

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